

NESTLÉ S.A.



LETTER OF COMMENT NO. 182

HERMANN WIRZ  
SENIOR VICE PRESIDENT

**INTERNATIONAL ACCOUNTING  
STANDARDS BOARD**  
30 Cannon Street

**GB-LONDON EC4M 6XH**

14 April 2009

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**DISCUSSION PAPER**  
**PRELIMINARY VIEWS ON FINANCIAL STATEMENT PRESENTATION**

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Ladies and Gentlemen,

Please find below our answer to your invitation to comment on the above mentioned discussion paper.

**GENERAL COMMENTS**

The Nestle Group reported sales of CHF 109.9 bio in 2008 and is the world's leading Nutrition Health and Wellness company. We employ around 283'000 people and had a market capitalisation of CHF 150 bio at end December 2008. We have been applying IAS and IFRS since 1989 and have consistently expressed our interest in the development of high quality financial reporting and we consider that it should be a communication exercise between companies and their present and future investors. We firmly believe in what we call "a one set of figures principle" whereby any information that is published to the investors should also be relevant to management in support of its decision process. Accordingly we express a great interest in the Board's DP on Financial Statement Presentation (the DP) and we welcome the Board's efforts to improve the communication between the preparers and the users. We give some general comments below and we answer the specific questions of the DP in the annexe.

We generally support the objectives of the DP; in particular the cohesive presentation of financial statements and a management approach that, in our opinion, should reflect the business model of an entity. However, cohesiveness should not be an end in itself and if it conflicts with the management approach the latter should always prevail.

Nevertheless we have concerns about several proposals of the DP, viz.:

- a) one single statement of comprehensive income,
- b) disaggregation of information by nature,
- c) cash flow statement prepared in accordance with the direct method,
- d) reconciliation between the statements of comprehensive income and of cash flows.

(a) Since the Board has accepted stewardship in its ED on the conceptual framework, objectives and qualitative characteristics, we have difficulty in understanding why the Board is now recommending a single statement of comprehensive income and is downgrading net profit as a mere sub-total of that statement. We consider that the income statement is the key document that demonstrates how management has delivered its stewardship duties towards the investors. The statement of other recognised income and expense displays re-measurements and items that would affect the results in later periods such as cash flow hedges and actuarial gains and losses. We consider that these two statements have distinct purposes and that they should be displayed separately with equal prominence among the primary statements.

(b) While we see the merit of disclosing certain information by nature, the Board should not lose sight that we (and many other groups) report internally and externally our expenses by functions using Activity Based Costing and Activity Based Management (ABC / ABM), therefore information by nature is not available at Group level. This is especially acute for costs of goods sold and distribution expenses. Therefore extensive disclosures by nature would require significant and costly system changes and ongoing work that, in our opinion, are not worth the purported benefits.

(c) The above comment would also apply to the presentation of a cash flow statement by the direct method, indeed this is further complicated by the fact that our related payables are generally recorded as a pool and cannot always be traced by nature and by function. We do not believe that it is feasible to obtain the data statistically by preparing a cash flow statement in accordance with the direct method "indirectly" because first we do not have all details by nature at group level (except salaries and depreciation and a few others) and second we would have to have recourse to high level estimates that would create a "black box" of un-reconciled items. Therefore the information would be neither reliable nor auditable.

(d) Since the analysis of expenses by nature and the direct cash flow method are too complex and impractical, we consider that the same applies to the reconciliation between the statement of comprehensive income and the statement of cash flow. We also have doubts about the usefulness of this reconciliation, since, as said above in our comment regarding comprehensive income, we believe that the focus should be on the income statement. This being said a reconciliation between operating profit and operating cash flow could be more useful than the one proposed in the DP.

In the previous paragraphs, we have explained our objections from our standpoint as a preparer but consideration should also be given to the point of view of the users. Nevertheless we doubt whether they need all the considerable changes that are proposed in the DP. A study published by Pricewaterhouse Coopers in 2007, revealed that investment professionals place a high importance on the income statement, segment reporting and the cash flow statement.

Furthermore we believe that investors require information regarding EBIT, underlying post-tax earnings figures (not comprehensive income), net debt, working capital, free cash flow, etc. We do not believe that the DP entirely supports this direction and hope that the Board will redirect the project when it issues its Exposure Draft on Financial Statement Presentation.

Thank you very much for your attention to this letter and its annexe.

Yours very truly,

NESTLE S. A.

H. Wirz  
Senior Vice President  
Head of Group Accounting and Reporting

Encl.

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**ANSWERS TO SPECIFIC QUESTIONS AND OTHER POINTS**

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**OBJECTIVES AND PRINCIPLES OF FINANCIAL STATEMENT PRESENTATION*****Question 1***

*Would the objectives of financial statement presentation proposed in paragraphs 2.5–2.13 improve the usefulness of the information provided in an entity's financial statements and help users make better decisions in their capacity as capital providers? Why or why not? Should the boards consider any other objectives of financial statement presentation in addition to or instead of the objectives proposed in this discussion paper? If so, please describe and explain.*

We would generally agree with the objectives exposed in paragraphs 2.5 to 2.13 in the DP in particular with the fact that financial statements should help the users to "assess the effectiveness with which management has fulfilled its stewardship responsibilities". However we consider that financial reporting should not be seen strictly from the standpoint of the users as mentioned in paragraph 2.1 lit (a). As we have said in our comment letter on the ED on an improved conceptual framework, objectives and qualitative characteristics, we consider that management is indeed a key user of financial statements as it uses them for decision making and in its communication with investors (present and future) as well as analysts. Therefore, while we generally agree with the direction of the DP, we have several reservations with it from the standpoint on how management uses financial reporting.

We would agree with cohesiveness but it should not be absolute and it should not give rise to unwarranted consequences that go against depicting a fair presentation of the economic activities of an entity, in particular we disagree that net income should be relegated to a mere component of total comprehensive income. This, we believe, downgrades the objective of assessing management stewardship. We also consider that cohesiveness should not be applied blindly and that exceptions to it are acceptable when they give a better understanding of the operations carried out by an entity (please see in particular our answer to question 5 (b)).

Whilst we would agree with the disaggregation objective, i.e., disaggregating additional line items to explain the components of the financial positions (§ 2.10) and grouping items with similar characteristics (§ 2.8), we have the impression the Board did not follow this objective throughout the DP, especially when it requires a full disaggregation by nature of the expenses by function.

As regards the liquidity, we consider that it is important that users be in a position to assess this, but, like certain users, we would have favoured to extend this objective to net debt, which is especially important when analysing the cash flow statement.

Above all we would favour a presentation of financial statements that is consistent with a management approach that reflects the business model of an entity.

### **Question 2**

*Would the separation of business activities from financing activities provide information that is more decision-useful than that provided in the financial statement formats used today (see paragraph 2.19)? Why or why not?*

We agree that regrouping all financing activities under one single activity provides better transparent information, which leads to the content of financing activities. These should normally encompass only finance that is raised from financial institutions and / or capital markets, i.e., the operations under the control of the Corporate Treasurer (excluding issuance of equity instruments). However we believe that the management approach should prevail in all circumstances.

### **Question 3**

*Should equity be presented as a section separate from the financing section or should it be included as a category in the financing section (see paragraphs 2.19(b), 2.36 and 2.52-2.55)? Why or why not?*

We strongly recommend that equity be presented as a separate section that should be distinct from the financing section. Since equity represents the funds raised by and owed to the owners of an entity, it cannot be mixed with financing that is raised from third parties. We support the arguments raised in 2.54 whereby it satisfies the cohesiveness objective to separate owner and non-owner financing.

### **Question 4**

*In the proposed presentation model, an entity would present its discontinued operations in a separate section (see paragraphs 2.20, 2.37 and 2.71–2.73). Does this presentation provide decision-useful information? Instead of presenting this information in a separate section, should an entity present information about its discontinued operations in the relevant categories (operating, investing, financing assets and financing liabilities)? Why or why not?*

We recommend that discontinued operations be presented in a separate section and not be integrated into operating, investing and financing activities. In its recent ED on proposed amendments to IFRS 5, the Board has proposed to restrict the definition of a discontinued operation to a segment as defined in IFRS 8, which we have supported. Since a discontinued operation would consequently represent the disinvestment from a sizeable part of an entity. We consider that such an operation should be disclosed as a separate activity in order to segregate it from the balance sheet position, profit or loss and cash flows from the continuing business.

In this context we however note that the ToolCo example (page 109 of the DP) labelled "assets held for sale" under discontinued operations. We strongly recommend not to mix discontinued operations with assets held for sale. While the former is rather infrequent, which justifies a separate activity, assets held for sale occur frequently, therefore, they are part of the normal operating, investing and financing of an entity and are properly classified under these activities and should be separately disclosed, if material.

### **Question 5**

*The proposed presentation model relies on a management approach to classification of assets and liabilities and the related changes in those items in the sections and categories in order to reflect the way an item is used within the entity or its reportable segment (see paragraphs 2.27, 2.34 and 2.39–2.41).*

*(a) Would a management approach provide the most useful view of an entity to users of its financial statements?*

As said in our answer to question 1, we believe that financial reporting is a communication exercise between preparers and users. Therefore, to be understandable financial statements should indeed present a management approach that is consistent with the business model of an entity. For this reason we have supported the management approach of IFRS 8. Comparability is indeed important to both preparers and users but it should apply only to recognition and measurement principles. Strict presentation and prescriptive rules would not achieve a fair presentation of an entity's activities and business model.

*(b) Would the potential for reduced comparability of financial statements resulting from a management approach to classification outweigh the benefits of that approach? Why or why not?*

We do not consider that a management approach would reduce comparability. The cohesiveness across activities, already achieves comparability but when one comes to the classification of such activities, we consider consistency should only apply from one period to another and that a management approach provides a better understanding of the business model and of the economics behind the assets, liabilities, profit or loss and cash flows of an entity. We therefore agree that the management approach regarding the classification should be explained in the accounting policies and that any change should be disclosed as a change in accounting policies as specified in § 2.41.

Nevertheless we consider that there is a dichotomy between the management approach as recommended in § 2.27 and the fact that § 2.29 requires that "the classification of assets and liabilities in the statement of financial position determines the classification of changes in those assets and liabilities in the statements of comprehensive income and cash flows". This leads to some rather prescriptive requirements, for example:

- treatment of dividends (per §§ 2.48 and 2.55): while we agree that a dividend payable is indeed a liability, we consider that it is not correct to include it under financing in the cash flow statement because, as dividend is paid to the owners, it is best placed under equity in the cash flow statement;
- equity share-based payments: while they are correctly classified in equity in the balance sheet, the related charge should appear under profit or loss;
- finance leases should be disaggregated between their related assets that are operating and the liabilities that are financing.

While we agree with cohesiveness, we consider that it should not be blindly applied and that a transparent picture of the economics of a transaction should always prevail.

**Question 6**

*Paragraph 2.27 proposes that both assets and liabilities should be presented in the business section and in the financing section of the statement of financial position. Would this change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows make it easier for users to calculate some key financial ratios for an entity's business activities or its financing activities? Why or why not?*

We believe that the analytical presentation of both assets and liabilities would enhance the way users calculate their ratios. However the management approach should prevail when classifying assets and liabilities that could appear both in operating and financing as said in our answer to question 5 above, the typical example being finance leases.

**Question 7**

*Paragraphs 2.27, 2.76 and 2.77 discuss classification of assets and liabilities by entities that have more than one reportable segment for segment reporting purposes. Should those entities classify assets and liabilities (and related changes) at the reportable segment level as proposed instead of at the entity level? Please explain.*

We would agree in principle with the arguments of § 2.77 that the classification at the reporting segment should prevail but if certain entities would arrive at a better presentation by classifying their assets and liabilities differently in total, they should not be prevented from doing so provided that they explain their treatment in their accounting policies and apply it consistently.

**Question 8**

*The proposed presentation model introduces sections and categories in the statements of financial position, comprehensive income and cash flows. As discussed in paragraph 1.21(c), the boards will need to consider making consequential amendments to existing segment disclosure requirements as a result of the proposed classification scheme. For example, the boards may need to clarify which assets should be disclosed by segment: only total assets as required today or assets for each section or category within a section. What, if any, changes in segment disclosures should the boards consider to make segment information more useful in light of the proposed presentation model? Please explain.*

We have difficulties to follow the reasoning of § 1.21 (c) whereby additional segment disclosures may be required as a consequence of a future IFRS on financial statement presentation. Since IFRS 8 is based on a management approach, such disclosures would contradict the objectives of this standard to disclose the information as it is presented to the Chief Operating Decision Maker. Moreover, as IFRS 8 § 28 requires to reconcile the segment revenue, profit or loss, assets, etc. to entity items as per the financial statements, we do not see the reason for any possible disclosures as stated in the DP.

**Question 9**

*Are the business section and the operating and investing categories within that section defined appropriately (see paragraphs 2.31–2.33 and 2.63–2.67)? Why or why not?*

We have concerns with the definition of "investing" as stated in § 2.33. The term "investing" is currently well understood by preparers and users as investments in PP&E, etc. as stated in IAS 7 § 16. We do not see a clear rationale for using it for another purpose although we would not object to the separation of the business activities into two parts but we would prefer to use the term of "non-core" for the category that is defined as in "investing" in 2.33. For the surplus we consider that the definitions are adequate.

**Question 10**

*Are the financing section and the financing assets and financing liabilities categories within that section defined appropriately (see paragraphs 2.34 and 2.56–2.62)? Should the financing section be restricted to financial assets and financial liabilities as defined in IFRSs and US GAAP as proposed? Why or why not?*

We would agree that the financing section should consist of financial liabilities that are used in the capital raising activities of entities under the supervision of Corporate Treasury (except issuance of equity instruments). Similarly financial assets that are also under the supervision of the Corporate Treasury should also be included under the financing section as financial assets. We also fully support the notion of "net debt" as explained in § 2.61. From the standpoint of cohesiveness the "net debt" definition should also be extended to profit or loss and, to the cash flow statement as far as net financing cost is concerned.

However we consider that the definition of "capital raising activities" should be based on the business model of the entity and not strictly on financial instruments as defined in IAS 39. For instance lease liabilities have also a capital raising nature and certain entities may want to treat financial instruments as operating such as, for example the finance division of a car company may want to treat the car loans granted to their dealers and the respective financing as operating.

Finally, as said in our answer to question 2, the management approach should prevail.

**IMPLICATIONS OF THE OBJECTIVES AND PRINCIPLES FOR EACH FINANCIAL STATEMENT**

**Question 11**

*Paragraph 3.2 proposes that an entity should present a classified statement of financial position (short-term and long-term subcategories for assets and liabilities) except when a presentation of assets and liabilities in order of liquidity provides information that is more relevant.*

- (a) What types of entities would you expect not to present a classified statement of financial position? Why?*
- (b) Should there be more guidance for distinguishing which entities should present a statement of financial position in order of liquidity? If so, what additional guidance is needed?*



We would not agree with a prescriptive guidance on how to distinguish between long term and short term and would consider that, in line with the management approach, it would be up to the entities to determine whether they would do the long term / short term distinction over more than one year or on the basis of their operating circle or liquidity order.

We disagree with the requirement of § 3.3 to split deferred tax assets and liabilities into short term and long term in order to converge to SFAS 109. We have doubts about the benefit of this information for the users because the split would be rather arbitrary as it is very difficult in most of the circumstances to estimate when temporary differences would crystallise.

### **Question 12**

*Paragraph 3.14 proposes that cash equivalents should be presented and classified in a manner similar to other short-term investments, not as part of cash. Do you agree? Why or why not?*

We agree and consider that the notion of cash equivalents as stipulated in IAS 7 § 6 is rule based and does not add value to the reporting. However entities' treasuries manage not only cash but also all short term investments and indebtedness. Therefore, in line with the net debt concept that we proposed in our answer to question 2, we recommend that the liquidity part of financing activities be not restricted to cash and that all short term investments be part of it rather than of investing activities. This would be in line with the management approach.

### **Question 13**

*Paragraph 3.19 proposes that an entity should present its similar assets and liabilities that are measured on different bases on separate lines in the statement of financial position. Would this disaggregation provide information that is more decision-useful than a presentation that permits line items to include similar assets and liabilities measured on different bases? Why or why not?*

While we consider that users need information about instruments that are measured under different bases, we believe that such a requirement should not be extended to the statement of financial position because it would unnecessarily overload this statement, make it less understandable and, contrary to the assertion of § 3.20, would impose costs on the preparers to program the disaggregation on the face of statement of financial position. This information would be better placed in the notes as already requested by IFRS 7 for financial instruments.

### **Question 14**

*Should an entity present comprehensive income and its components in a single statement of comprehensive income as proposed (see paragraphs 3.24–3.33)? Why or why not? If not, how should they be presented?*

We disagree with one single statement of comprehensive income even if net profit is maintained as a sub-total and we strongly recommend that the distinction between income statement (or profit or loss) and other comprehensive income (or SORIE) be maintained. We disagree with the assertion of § 3.29 whereby a single statement of comprehensive income will improve the comparability of the financial statements. In its ED on the Conceptual Framework, Objectives and Qualitative Characteristics, we were pleased to note that the Board had introduced stewardship as a qualitative characteristic. The logical consequence is to retain the income statement that represents the set of operations that management is accountable for to the shareholders and that it uses to conduct the business, while other comprehensive income deals with remeasurement and items that would affect the results in later periods such as cash flow hedges and actuarial gains and losses.

The presentation of net income as it stands in the DP would also no longer allow the preparers to report the net profit attributable to the minority interests. In our comments on the DP on the economic entity, we have expressed our disagreement to retain the economic entity approach rather than the parent company approach that is aligned with stewardship. We are therefore concerned about the inconsistency that is created by accepting stewardship on the one hand and not permitting entities to report the profit attributable to the Group shareholders.

We are also not convinced by the arguments of the Board in § 3.30 and § 3.35 that state that the option of presenting two statements in IAS 1 rev 2007 and the introduction of a net income sub-total in comprehensive income in the DP are designed to allow the preparers and users to be familiar with the statement of comprehensive income. By this assertion we believe that the Board just considers that preparers and users have to be educated without reliably demonstrating the usefulness of a single statement of comprehensive income.

Finally we disagree with the assertions that one single statement of comprehensive income is necessary to achieve high quality standards (§ 3.28), that it is easier to look at one statement (§ 3.29) and that users would fail to react to information that is located in unexpected locations (§ 3.31). We do not consider that a separate statement of other comprehensive income shown with the same prominence as the income statement as one of the five primary statements of an entity could be qualified as an unexpected location. On the contrary we are convinced that the distinction between the operations that affect the performance of an entity in a given period and those which are related to remeasurements or which will affect the performance in a future period makes sense and is helpful to the users. We understand that analysts require underlying post tax earnings and not comprehensive income (CRUF - IASB meeting of 10 June 2008, [http://www.cruf.co.uk/cruf\\_iasb\\_10\\_june\\_08\\_cashflow.pdf](http://www.cruf.co.uk/cruf_iasb_10_june_08_cashflow.pdf)).

Since we understand that the Board considers that net income is just "a page break" issue, why would the Board insist for one single statement and would not allow preparers to present two statements that play a key role in the communication of entities with their users?

**Question 15**

*Paragraph 3.25 proposes that an entity should indicate the category to which items of other comprehensive income relate (except some foreign currency translation adjustments) (see paragraphs 3.37–3.41). Would that information be decision-useful? Why or why not?*

We consider that this allocation makes sense but it should be limited to the operating and financing categories. Any further detail would create complexity in order to track the elements of other comprehensive income.

**Question 16**

*Paragraphs 3.42–3.48 propose that an entity should further disaggregate within each section and category in the statement of comprehensive income its revenues, expenses, gains and losses by their function, by their nature, or both if doing so will enhance the usefulness of the information in predicting the entity's future cash flows. Would this level of disaggregation provide information that is decision-useful to users in their capacity as capital providers? Why or why not?*

While we see some merits in a disaggregation by nature, especially when management controls certain expenses outside the functions because such expenses are unrelated to the normal process of an entity (§ 3.50) such as impairment losses, losses on assets and receivables as well as restructuring costs, we have serious reservations concerning a full disaggregation by nature of the expenses by functions.

Our Group and several others apply Activity Based Costing and Activity Based Management which result in regrouping expenses by buckets such as manufacturing, distribution and administration. Information by function exists at the entity's level in the cost management systems but it is not codified in the transactional systems in such a way that it could be easily retrieved in the reporting and consolidation systems. The management of our Group does not review information by nature. For the purpose of IAS 1 § 104 disclosures we are tracing separately and on a statistical basis depreciation as well as salaries. However, the assertion of § 3.54 that the disaggregation by nature might not result in a major change of practice would not hold. This would be especially difficult for cost of goods sold, the components of which, such as materials, labour, freight, handling and other overheads, are lost when the cost of production of a period is aggregated with the inventory variation. Expenses by nature are not traced beyond the cost of production that is prepared at the level of each manufacturing centre. Tracing the COGS expenses by nature at each reporting entity and then at group level would represent a tremendous change of both our transactional systems and of our reporting and consolidation systems. We do not believe that the costs of such a major change would justify its benefits.

**Question 17**

*Paragraph 3.55 proposes that an entity should allocate and present income taxes within the statement of comprehensive income in accordance with existing requirements (see paragraphs 3.56–3.62). To which sections and categories, if any, should an entity allocate income taxes in order to provide information that is decision-useful to users? Please explain.*

We agree with the requirements of § 3.55 stating that an entity should allocate income taxes to discontinued operations and other comprehensive income but should not allocate income taxes to the business or financing sections of profit or loss. We support the arguments of § 3.60 whereby the allocation to these categories would be arbitrary. Such allocation could also be misleading and would therefore not be of benefit to the users.

### **Question 18**

*Paragraph 3.63 proposes that an entity should present foreign currency transaction gains and losses, including the components of any net gain or loss arising on remeasurement into its functional currency, in the same section and category as the assets and liabilities that gave rise to the gains or losses.*

- (a) *Would this provide decision-useful information to users in their capacity as capital providers? Please explain why or why not and discuss any alternative methods of presenting this information.*
- (b) *What costs should the boards consider related to presenting the components of net foreign currency transaction gains or losses for presentation in different sections and categories?*

We consider that, while the proposals make sense, they should be applied pragmatically by distinguishing financial assets and liabilities from the business ones. Reporting transaction gains and losses related to financial assets and liabilities into the same category as the related assets and liabilities certainly makes sense and we are already doing this. However relating gains or losses on commercial positions to their assets and liabilities in the income statement would cause important practical difficulties because these are embedded in COGS and in the various components of distribution and selling and administrative expenses. Therefore we do not see the benefit for tracing them separately. This demonstrates that the limits of cohesiveness and the importance of following a management approach.

### **Question 19**

*Paragraph 3.75 proposes that an entity should use a direct method of presenting cash flows in the statement of cash flows.*

- (a) *Would a direct method of presenting operating cash flows provide information that is decision-useful?*

While we could agree that the presentation of the cash flow statement should be reviewed because IAS 7 is an old standard (first issued in December 1992), we disagree with the direct method both on the grounds of supplying reliable information to the users and of practicability.

We understand that the main criticism from the users' standpoint are as follows (CRUF - IASB meeting of 10 June 2008, [http://www.cruf.co.uk/cruf\\_iasb\\_10\\_june\\_08\\_cashflow.pdf](http://www.cruf.co.uk/cruf_iasb_10_june_08_cashflow.pdf)):

- reconciliation between the movement of cash and net debt, whose movement should appear on the face of the cash flow statement;
- greater consistency in the starting point for cash flow statement
- lack of information about free cash flow.

In the same quoted document, CRUF consider that it is impossible to get the "right format of the cash flow". We fully support CRUF's remarks because the three above mentioned issues are also issues for the preparers. Our internal cash flow analyses are also designed to explain the movements of net debt and free cash flow. Therefore we urge the IASB to leave the current possibility to prepare the cash flow statement in accordance with both the indirect and direct method but to enhance IAS 7 in order to address its shortcomings.

Producing a cash flow statement on the direct method would require a fundamental review of all the transactional, reporting and consolidation systems of most of the enterprises. The direct cash flow method is too complex and impractical due to the following factors:

- Various assets and liabilities particularly trade payables are not recorded at the functional level e.g. salary and related costs payable are never recorded separately for the Cost of Goods Sold, Marketing Expenses, and Administrative Expenses etc. These are generally recorded as a pool of salary payables. Similarly, while expenses are recorded separately by their nature, the corresponding payables are pooled together and recorded as a single payable in basic books of account. This is even further complicated when shared service centres are involved for transactional operations.
- Moreover, payables if recorded at the proposed function level would need to be pooled together again for making payments and discharging liabilities.
- Some costs, e.g. retirement benefit expenses, are managed for the entity as a whole in separate legal entities (i.e., retirement benefit foundations) but are allocated to income statement at functional level based on some allocation drivers on a periodical basis. The split of these liabilities (captured and managed as one number) to derive cash flows at functional level will be purely arbitrary as these are accumulated payables and the same annual allocation drivers cannot be used without distorting the accuracy / usefulness of the information.
- Accordingly, if the cash flow statement had to be constructed in accordance with the direct method, and to allow the reconciliation with comprehensive income, it would mean:
  - Increased transactional data i.e. basic data of various payables need to be captured at each function and line level resulting in significant investment in IT infrastructure, servers etc..
  - Since the information would have to be checked and reviewed this would require additional resources in terms of staff.
  - Since the volume of the reporting would increase, audit fees would follow upwards proportionately.

*(b) Is a direct method more consistent with the proposed cohesiveness and disaggregation objectives (see paragraphs 3.75–3.80) than an indirect method? Why or why not?*

An enhanced cash flow statement as proposed under our answer to question 19 (a) would also meet the cohesiveness objective in as much as this objective is applied pragmatically. As we said in our answer to question 1, cohesiveness should be neither absolute nor be an end in itself, nor have unwarranted consequences. Furthermore we consider that the main categories based on the balance sheet can also be used with the indirect method and cohesiveness is not impaired by that method.

*(c) Would the information currently provided using an indirect method to present operating cash flows be provided in the proposed reconciliation schedule (see paragraphs 4.19 and 4.45)? Why or why not?*

As stated in our answer to question 19 (a) above, we believe that the users acknowledge that it is impossible to obtain the "right format of the cash flow", therefore if the operating section of the cash flow statement in accordance with the indirect method is enhanced we consider that it is not necessary to impose the direct method. In particular we would agree with CRUF (presentation quoted above) that additional information should be disclosed concerning the components of working capital and, in particular trade working capital. We already provide those type of analyses to our management.

### **Question 20**

*What costs should the boards consider related to using a direct method to present operating cash flows (see paragraphs 3.81–3.83)? Please distinguish between one-off or one-time implementation costs and ongoing application costs. How might those costs be reduced without reducing the benefits of presenting operating cash receipts and payments?*

As we said earlier in this comment letter, the complexity is driven by a combination of three requirements that would influence on our systems, i.e., the analysis by nature in profit or loss and other comprehensive income, the direct cash flow method and the consequential line by line reconciliation. This would require a complete remodelling of our transactional, reporting and consolidation systems for which we first discuss, as asked in the question, the one-time modifications and then the consequential on-going costs.

As already explained in our answer to question 16, our costing system is organised into "buckets", i.e., manufacturing distribution and administration. Therefore while the expenses are captured by nature in the transactional systems, they are then allocated by functions in the three "buckets" and their origin by nature is lost in the cost management reporting system. Moreover, as was explained in our answer to question 19, the receivables, payables and accruals are pooled and it is consequently not possible to trace the cash movements by nature to arrive at a cash flow statement in accordance with the direct method. In accordance with the application of ABC and ABM our costs are controlled by activity and not by nature for which we have no details.

The biggest obstacle concerns the cost of goods sold (COGS) which is quite complex. It starts with the standard cost of production followed by allocation of variances. These variances are populated into different GL Codes between the consumption and the inventories so reconciliation is much more complex than just addition of line items. Moreover, as already said in our answer to question 16 the detail by nature of the inventories is lost once they are incorporated in the COGS. This is further complicated by the fact that, in our importing entities, purchases from affiliated companies are integrated in

the COGS structure of the selling entity which does not have the detail of the cash flows pertaining to such costs. This latter point does not apply only to manufacturing costs but also to distribution ones.

In § 3.82 the Board contends that "an entity generally could determine [cash inflows and outflows] indirectly by adjusting the related revenue and expenses for the change during the period in the amount of the related asset and liability". This might be true in an SME with a simple structure but is, however not feasible in a multinational group in general and in our Group in particular because, as already explained, all our cost management is based on ABC / ABM and we do not have any detail by nature at Group level. Therefore the adjustments would have to be made on the basis of estimates at high level and would be neither reliable nor auditable. Moreover such type of adjustments would be time consuming and, since all companies try to reduce the time spent on the publication of their accounts there are no other solutions but to extract the information out of the transactional system which, as explained below would be time consuming and very costly.

From a system point of view the request to present expenses by nature, cash flow in accordance with the direct method and the reconciliation of the two would cause a complete redesign of our systems as follows:

- It would cause a proliferation of the transactional data to be captured at each function and line level resulting in significant investment in IT infrastructure, servers etc.
- We would have to completely redesign the reporting and consolidation system in order to retrieve, aggregate and control the data of expenses by nature and cash flow statement by the direct method at Group level. Since we would have to produce this information for pure compliance purposes we would have to build a system in parallel to our current reporting systems.

Moreover, we disagree with the Board's assertion in § 3.83 that the costs of changing the systems (already huge as explained above) would be one time. The complexity created by the DP's proposals would also cause on-going costs because:

- The compliance data mentioned above would have to be regularly controlled to insure its accuracy and reconciled to our usual performance data to ensure that it is auditable.
- Since Management would like to explain the Group performance to the users on the basis of data that they use to conduct the business and not on the basis of theoretical compliance data, a considerable amount of time would be wasted in preparing reconciliations and explaining them to Management.
- The above would result in hiring additional staff and in permanent additional system maintenance.
- Audit expenses would significantly increase due to the audit of the compliance data and the review of the performance data.
- Last but not least, users would be confused between the Management performance and the compliance performance. This would be the end of our "one set of figures" concept mentioned in the covering letter of these comments.

### **Question 21**

*On the basis of the discussion in paragraphs 3.88–3.95, should the effects of basket transactions be allocated to the related sections and categories in the statement of comprehensive income and the statement of cash flows to achieve cohesiveness? If not, in which section or category should those effects be presented?*

We would favour alternative C, i.e., a separate section for basket transactions such as acquisitions and disposal. However we acknowledge that users need additional information regarding the components of these transactions. Therefore we would recommend that the components of basket transactions be disclosed in the notes.

As an additional point we consider that the term "multi-category transactions" would be better than "basket transactions".

### **NOTES TO FINANCIAL STATEMENTS**

### **Question 22**

*Should an entity that presents assets and liabilities in order of liquidity in its statement of financial position disclose information about the maturities of its short-term contractual assets and liabilities in the notes to financial statements as proposed in paragraph 4.7? Should all entities present this information? Why or why not?*

As regards the order of liquidity we consider that, on the basis of the management approach it would be up to the entities to explain in their accounting policies whether they would present their balance sheet in the order of liquidity or on the basis of a short term / long term definition.

We do not see the necessity to discuss the issue of contractual maturities in the DP, nor to include any requirement thereon because requirements and guidance already exist in IFRS 7 § 39 and appendix B § B11 ss. There are also disclosure of maturity requirements for leases in IAS 17 § 31. Should the Board consider that the requirements of IFRS 7 are not adequate, it should explain the reason why. From our reading of the DP, we do not have the impression that it is the case

### **Question 23**

*Paragraph 4.19 proposes that an entity should present a schedule in the notes to financial statements that reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components:*

*(a) cash received or paid other than in transactions with owners, (b) accruals other than remeasurements, (c) remeasurements that are recurring fair value changes or valuation adjustments, and (d) remeasurements that are not recurring fair value changes or valuation adjustments.*

*(a) Would the proposed reconciliation schedule increase users' understanding of the amount, timing and uncertainty of an entity's future cash flows? Why or why not? Please include a discussion of the costs and benefits of providing the reconciliation schedule.*



As highlighted above, the direct cash flow method is too complex and impractical to be implemented at real operational levels; the same applies to the reconciliation schedule. This is because the cash flow presented (at the proposed function and nature of expenses level) is a derived amount taking into account the amounts recognised as per the fundamental accrual accounting principles and adjusted for various accruals and measurements / valuations as specified in the diagram of § 4.45.

We also disagree with the Board's assertion in the appendix B §§ B17 to B19. As we have said earlier in our comments, we do not consider that the focus should be on comprehensive income but on net income and operating income because these are the performance criteria for which management is accountable.

As such the additional reconciliation schedule as proposed in § 4.19 ss. is not likely to bring any additional information / benefits to the users of the financial statements in determining the future cash flows in terms of timing and uncertainties as far as the ongoing continuing businesses are concerned. In any case most of the entities present the information on significant exceptional / non-recurring items.

*(b) Should changes in assets and liabilities be disaggregated into the components described in paragraph 4.19? Please explain your rationale for any component you would either add or omit.*

As stated in our answer to question 23 (a) we disagree with the reconciliation as proposed in the DP. Therefore we strongly recommend that other type of information be made available to the users in the form of a reconciliation between Operating Profit and Operating Cash Flow, which could be achieved by changing the indirect cash flow method. Such a reconciliation would highlight non-recurring items, which coupled with discontinued operations as separate disclosure items, would enable users to assess the impact of these transactions while predicting future cash flows. As regards re-measurements and fair value changes we consider that these are already available in other comprehensive income.

*(c) Is the guidance provided in paragraphs 4.31, 4.41 and 4.44–4.46 clear and sufficient to prepare the reconciliation schedule? If not, please explain how the guidance should be modified.*

As said in our answers to questions 23 (a) and (b) and to those of questions 19 and 20 on the direct cash flow method, we disagree with these requirements, which would drive huge costs in terms of IT and staff resources, whose benefits are not clearly established. Therefore we disagree with the guidance mentioned in question 23 (c) above because we consider that it is not applicable.

#### **Question 24**

*Should the boards address further disaggregation of changes in fair value in a future project (see paragraphs 4.42 and 4.43)? Why or why not?*

In October 2008 the Board published an ED in Improving Disclosures about Financial Instruments, which we basically agreed with in our comment letter of 15 December 2008. On the basis of our previously mentioned comment letter and also on the basis of our

answer to question 23, we do not consider that any additional disclosures on fair value are necessary.

### **Question 25**

*Should the boards consider other alternative reconciliation formats for disaggregating information in the financial statements, such as the statement of financial position reconciliation and the statement of comprehensive income matrix described in Appendix B, paragraphs B10–B22? For example, should entities that primarily manage assets and liabilities rather than cash flows (for example, entities in the financial services industries) be required to use the statement of financial position reconciliation format rather than the proposed format that reconciles cash flows to comprehensive income? Why or why not?*

We do not agree with the alternative reconciliation formats.

We consider that the Statement of Financial Position Reconciliation proposed in § B11 ss. presents the same drawbacks as the reconciliation proposed in question 23 because it also disaggregates cash flows by the three accrual elements which are impracticable as already explained in this letter.

As regards the Statement of Comprehensive Income Matrix proposed in § B14 ss, we have already explained that focus should not be made on comprehensive income but rather on operating income and net income. Therefore we consider that users could obtain the same information in a simpler way by disclosing separately remeasurements such as impairment losses, gains or losses on sale on assets, etc. in an income statement presented on one column.

Finally a reconciliation between operating profit and operating cash flow as proposed in our answer to question 23 may add more value to the users as the above proposed reconciliations.

### **Question 26**

*The FASB's preliminary view is that a memo column in the reconciliation schedule could provide a way for management to draw users' attention to unusual or infrequent events or transactions that are often presented as special items in earnings reports (see paragraphs 4.48–4.52). As noted in paragraph 4.53, the IASB is not supportive of including information in the reconciliation schedule about unusual or infrequent events or transactions.*

*(a) Would this information be decision-useful to users in their capacity as capital providers? Why or why not?*

*(b) APB Opinion No. 30 Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, contains definitions of unusual and infrequent (repeated in paragraph 4.51). Are those definitions too restrictive? If so, what type of restrictions, if any, should be placed on information presented in this column?*

*(c) Should an entity have the option of presenting the information in narrative format only?*

While information about items that are special, infrequent, non recurring, etc. is appealing at first sight, we consider that it would be very difficult to arrive at a definition of those items that would not be rule-based. Therefore such items should not be defined in a prescriptive manner. Nevertheless entities should not be prohibited to define such items as an accounting policy choice applied consistently.

***Question specific to the FASB***

This is not applicable to us.

**OTHER POINT**

***Disclosure of non-cash activities***

The requirement of 4.16 would be unnecessary with the indirect method for the cash flow statement.